Listed under A&W Revenue Royalties Income Fund.

A&W Food Services of Canada Inc.

Consolidated Financial Statements

December 28, 2003 and December 29, 2002

Provided as a supplement to the financial statements of A&W Revenue Royalties Income Fund

Management's Discussion and Analysis

The following is a discussion of the consolidated financial position and results of operations of A&W Food Services of Canada Inc. ("Food Services"). It should be read in conjunction with the audited Consolidated Financial Statements of Food Services which are on pages 6 to 14.

Selected Financial Information

(dollars in thousands)

	Year ended December 28, 2003	Year ended December 29, 2002
System sales	$ 475,370	$ 446,829
System sales % change	6.4%	3.2%
Same store sales % change	1.8%	-1.4%
New restaurants opened	34	26
Restaurants closed	13	10
Number of restaurants	634	613
Franchising and corporate restaurant revenue	$ 48,641	$ 45,481
Direct costs and administrative expenses	35,012	32,282
Operating contribution	13,629	13,199
Dividend income	3,016	2,282
Royalty expense	13,633	11,452
Net earnings for the year	4,442	18,039

Overview

Food Services is the franchisor of the A&W restaurant chain in Canada and derives revenues from franchise fees, sales in corporate-owned restaurants, sales of goods and services to franchisees, initial and regrant franchise fees, lease guarantee fees, and other fees. Food Services also receives revenue from its subsidiary's sales of flavour concentrate to a licensed bottler who produces and distributes A&W Root Beer for sale in retail grocery stores.

Food Services' direct costs and administrative expenses include the cost of materials and supplies and equipment sold either directly to franchisees or to distributors that service the restaurants. In addition, direct costs include the expenses and costs of the nine corporate restaurants operated by Food Services. Also included are salaries and general and administrative costs associated with providing services to the franchised A&W restaurants and establishing new A&W restaurants.

Food Services, through its investment in A&W Trade Marks Inc. ("Trade Marks"), owned during 2003 the equivalent of 28% of the units of the A&W Revenue Royalties Income Fund (the "Fund"), up from 25% in 2002, and receives dividend income from this source.

Food Services licences the A&W trade-marks from the Fund in exchange for a royalty fee of 3% of the sales of the A&W restaurants in the royalty pool of the Fund.

The royalty pool is adjusted in January of each year to reflect sales from new restaurants, net of the sales of any A&W restaurants that have closed. The Fund pays Food Services for any increase in the royalty from these new restaurants on the basis of a formula set out in the licence agreement.

System Sales

Total system sales for all A&W restaurants in Canada in 2003 were $475,370,000, an increase of 6.4% or $28,541,000 from 2002. This increase is due primarily to the increased number of restaurants and same store sales growth. This compares very favourably with the Quick Service Restaurant (QSR) industry in Canada and A&W's major competitor in Canada.

SYSTEM SALES GROWTH

	Year ended December 28, 2003	Year ended December 29, 2002
A&W	6.4%	3.2%
Major Competitor*	4.0%	2.0%
Canadian QSR Industry**	4.5%	-0.8%

* As reported by the competitor in print media
** As reported by Statistics Canada

Same store sales at A&W restaurants grew by 1.8% in 2003 despite very difficult conditions in the foodservice industry. The industry continued to face challenges as a result of the lingering effects of Severe Acute Respiratory Syndrome ("SARS") and a much stronger Canadian dollar. These factors and the forest fires in British Columbia and Alberta resulted in a significant decline in tourism and travel in the peak summer months. A major power outage in central Canada further depressed restaurant sales. A&W's positive same store sales growth for the year, despite these adverse conditions, is a tribute to its three pillars of trust: strategic management of the A&W brand, Climate, and experienced leadership.

New Restaurant Development and Restaurant Closures

A&W opened 34 new franchised restaurants in 2003, and closed 13 restaurants, for a net gain of 21 new restaurants, compared to a net gain of 16 restaurants in 2002.

NEW RESTAURANT GROWTH

	Year ended December 28, 2003	Year ended December 29, 2002
Western Canada	8	14
Ontario/Quebec/Atlantic	26	12
Total new restaurants	34	26
Restaurants closed	13	10
Net new restaurants	21	16

The increase in the number of closed restaurants in 2003 versus 2002 is due to a greater number of lease expires on low-volume restaurants located in shopping centres that were no longer economically viable. In these cases, Food Services, in conjunction with the respective franchisees, chose not to renew the leases and the restaurants subsequently closed.

In 2004, Food Services intends to maintain its level of new restaurant openings, with a continued emphasis on openings planned for Ontario, Quebec and Atlantic Canada, provided appropriate locations and franchisees can be secured.

(Note that the number of restaurants added to the Fund each year differs from the number of restaurant openings and closings reported by Food Services on an annual basis, as the period for which they are reported varies slightly.)

Expansion of the Royalty Pool

On January 5, 2003, the number of A&W restaurants for which royalties are paid to the Fund increased by 27 new restaurants less eight restaurants which permanently closed during 2002, bringing the total number of restaurants in the royalty pool to 604 and increasing Food Services' equivalent ownership of the units of the Fund to 28%, up from 25% in 2002. Trade Marks paid Food Services $5,108,000, by issuance of 452,469 Class B and common shares, as consideration for the royalty stream from the 19 net restaurants added to the royalty pool.

On January 5, 2004, the number of A&W restaurants for which royalties are paid to the Fund was increased by 28 new restaurants less 12 restaurants which permanently closed during 2003. Trade Marks paid Food Services $5,134,000, by issuance of 488,476 Class B and common shares, as initial consideration for the estimated royalty stream from the 16 net restaurants added to the royalty pool. A final adjustment to the share consideration will be made in December 2004 based upon the 2004 sales reported by the new restaurants. Twenty percent of the shares are held in escrow until the 2004 sales of the new restaurants are known. After the January 5, 2004 amendment to the royalty pool, Food Services owns the equivalent of 31% of the units of the Fund on a fully-diluted basis.

2003 Operating Results

REVENUE

Franchising and corporate revenues increased by $3,160,000 to $48,641,000 in 2003 from $45,481,000 in 2002. This increase is a combination of increased revenue from all areas of the business except initial fees and sales of equipment to restaurants, which were lower based on the number of new restaurants opened due to some new restaurants being converted from an existing chain.

DIRECT COSTS AND ADMINISTRATIVE EXPENSES

Direct costs and administrative expenses increased by $2,730,000 to $35,012,000 in 2003 from $32,282,000 in 2002 in keeping with the increase in revenue from franchising and corporate restaurants. Operating contribution margin decreased from 29% in 2002 to 28% in 2003 due to increased investment in menu innovation and new restaurant development during 2003.

DIVIDEND INCOME

Dividend income increased from $2,282,000 in 2002 to $3,016,000 in 2003. The variance is due to 2002 being a partial year as the Fund commenced operations February 15, 2002, and to the increase in the equivalent ownership of the Fund from 25% in 2002 to 28% in 2003.

ROYALTY EXPENSE

Total royalties paid to the Fund for the use of the trade-marks were $13,633,000 compared to $11,452,000 in 2002. The increase is due to the partial year in 2002 and to the increased number of restaurants in the royalty pool in 2003.

NET EARNINGS

Net earnings for the year decreased by $13,597,000 to $4,442,000 in 2003 from $18,039,000 in 2002. The higher earnings in 2002 reflected the sale of the A&W trade-marks to the Fund. The transaction gave rise to unusual, non-recurring expenses of $1,958,000 in 2002, a tax liability of $8,433,000, and a recovery of future income taxes of $24,577,000. Interest and amortization costs were also lower year-over-year, due to the sale in 2002 of the A&W trade-marks and the subsequent repayment of all long-term debt.

Liquidity and Capital Resources

As at December 28, 2003, Food Services had a deficit. The deficit arose in 2002 at the time of the sale of the A&W trade-marks and the payment of dividends to the shareholders. In accordance with GAAP, the gain on the sale of the trade-marks was deferred and will be amortized over the term of the licence for the use of the trade-marks, eliminating the deficit as follows:

NET EQUITY
(dollars in thousands)

	Year ended December 28, 2003	Year ended December 29, 2002
Deficit	$ (8,811)	$ (10,885)
Deferred accounting gain on sale of A&W trade-marks	32,243	29,644
Less related tax recovery	(3,498)	(3,338)
	19,934	15,421
Capital stock	10,500	10,500
Net equity, including deferred gain	$ 30,434	$ 25,921

Food Services has sufficient cash on hand to meet its obligations. The company has minimal capital requirements related to the corporate restaurants and head office. Future restaurant growth will continue to be funded by franchisees.

Critical Accounting Estimates

There are no critical accounting estimates that, if changed, would materially affect Food Services' overall financial condition or results of operations.

Contractual Obligations

OPERATING LEASES

The company has base rental obligations under operating leases for premises, equipment and automobiles. Certain of the premises leases require additional payments contingent on sales volume. The company generally arranges premises leases and enters into agreements whereby the company licences the premises to the franchisee, for which the company receives a premises licence fee. Under the terms of the agreements, the franchisee assumes all rights and obligations under the lease. Accordingly, the company records net lease expense in its Consolidated Statements of Earnings.

The annual rental payments, excluding contingent rentals, are as follows:

OPERATING LEASES
(dollars in thousands)

	Lease Obligations	Subleases	Net lease Liability
For year ending December 31			
2004	$ 15,525	$ 14,431	$ 1,094
2005	14,807	13,767	1,040
2006	14,446	13,525	921
2007	13,720	12,960	760
2008	12,778	12,163	615
Balance of commitments	73,635	72,136	1,499
	$ 144,911	$ 138,982	$ 5,929

PURCHASE OBLIGATIONS AND LEASE AND MORTGAGE GUARANTEES

The company has lease and mortgage guarantees of $327,000 (2002 - $338,000) and purchase obligations for supply to franchisees for food supplies, packaging and equipment of $17,028,000 (2002 - $16,828,000).

NATIONAL ADVERTISING FUND

The company maintains an advertising fund that is supported by prescribed contributions from corporate and franchise restaurants. At December 28, 2003, the fund had a surplus balance of $242,000 (2002 - $93,000).

Risks and Uncertainties

The success of Food Services is dependent on the ability of Food Services to (i) grow same store sales, (ii) maintain and grow the current system of franchises, (iii) locate new retail sites in prime locations and (iv) obtain qualified operators to become A&W franchisees.

Sales are subject to a number of factors that affect the restaurant industry generally and the quick service segment of this industry in particular, including the highly competitive nature of the industry, traffic patterns, demographic considerations and the type, number and proximity of competing quick service restaurants. In addition, factors such as the availability of experienced management and hourly employees may adversely affect the sales of the quick service restaurant industry in general and the sales of A&W restaurants in particular.

Food Services competes with other companies, including other well-capitalized franchisors with extensive financial, technological, marketing and personnel resources and high brand name recognition and awareness. There can be no assurance that Food Services will be able to respond successfully to various competitive factors affecting the franchise operations of Food Services in the quick service restaurant industry.

Any significant event that adversely affects consumption of hamburgers, chicken, fries and soft drinks (such as cost, changing tastes or health concerns) could adversely impact the sales of A&W restaurants.

Food Services faces competition for retail locations and franchisees from its competitors and from franchisors of other businesses. Food Services' inability to successfully obtain qualified franchisees could adversely affect its business development.

Food Services and A&W franchisees may be the subject of complaints or litigation from guests alleging food-related illnesses, injuries suffered on the premises or other food quality, health or operational concerns. Adverse publicity resulting from such allegations may materially affect the sales of A&W restaurants, regardless of whether such allegations are true or whether Food Services or an A&W franchisee is ultimately held liable.

Outlook

The Canadian economy is generally forecast to be stronger in 2004 than it was in 2003. Food Services projects that A&W's three pillars of trust – strategic management of the A&W brand, Climate, and experienced leadership – will continue to produce system sales results which outpace the Quick Service Restaurant industry.

In 2004, Food Services will continue to focus on a number of strategic initiatives aimed at accelerating progress toward its Mission to "become the number one choice of the baby boomer generation".

RESTAURANT RE-IMAGING

A&W is currently in the midst of a major restaurant re-imaging program. The re-imaging program incorporates a number of A&W design features which research has shown evoke fond memories in baby boomer customers. Re-imaged restaurants in a control group of test restaurants delivered sales improvements in excess of 5%. One hundred and thirty-one freestanding restaurants have now been re-imaged with new colours, graphics and signage and 46 are in progress or signed up to complete the program. A further 50 are anticipated to be completed in 2004.

NEW MENU BOARDS

During 2003, A&W restaurants were refitted with new menu boards. The new boards improve product merchandising and have delivered a 2% increase in the average cheque in a control group of test restaurants. These new menu boards were installed in substantially all restaurants in 2003, and the remainder will be completed in 2004.

CLIMATE GOAL PROGRAM EXTENSION

A&W's Climate Goal program is a successful workplace initiative that has reduced employee turnover and increased commitment to outstanding food and service. In 2003, A&W continued to extend and strengthen the Climate Goal program in A&W restaurants and this will be further extended in 2004.

ONGOING MENU INNOVATION

A&W has invested significantly in ongoing menu innovation and development. This will continue in 2004 as A&W implements further new menu innovation to appeal to its baby boomer customer base.

In 2004, Food Services will continue its strategic focus on baby boomers and, in addition to completing the roll out of the new menu boards and continuing the restaurant re-imaging program, the company will undertake work on several new initiatives related to this strategy, including:

- Building on the strength of last year's advertising campaign to strengthen A&W's bond with boomers.
- Continued implementation of ongoing sales promotion and marketing programs to build trial and repeat business.

This Management Discussion and Analysis contains certain forward-looking statements based on assumptions that management considered reasonable at the time they were prepared. These forward-looking statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by the forward-looking statements. Some of the factors that could cause results or events to differ from current expectations include, but are not limited to, the risk factors described previously.

Management's Responsibility

The accompanying consolidated financial statements are the responsibility of management and have been reviewed and approved by the Board of Directors. The consolidated financial statements have been prepared by management, in accordance with Canadian generally accepted accounting principles and, where appropriate, reflect management's best estimates and judgements. Management has also prepared financial and all other information in the annual report and has ensured that this information is consistent with the consolidated financial statements. The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting.

The company maintains appropriate systems of internal control, policies and procedures which provide management with reasonable assurance that assets are safeguarded and the financial records are reliable and form a proper basis for preparation of financial statements.

The consolidated financial statements have been independently audited by PricewaterhouseCoopers LLP, in accordance with Canadian generally accepted auditing standards. Their report below expresses their opinion on the consolidated financial statements of the company.

Jefferson Mooney
Chairman and Chief Executive Officer

Senior Vice President and
Chief Financial Officer

Auditors' Report

To the Shareholders of
A&W Food Services of Canada Inc.

We have audited the consolidated balance sheets of A&W Food Services of Canada Inc. as at December 28, 2003 and December 29, 2002 and the consolidated statements of earnings and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 28, 2003 and December 29, 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Vancouver, British Columbia
January 20, 2004

Consolidated Balance Sheets

(in thousands of dollars)

	December 28, 2003	December 29, 2002
ASSETS		
Current assets		
Cash and cash equivalents	$ 4,540	$ 11,054
Accounts receivable	8,075	5,948
Inventories	1,035	846
Dividends receivable (note 11)	334	258
Prepaid expenses	30	35
Future income taxes (note 8(c))	272	207
	14,286	18,348
Investment in A&W Trade Marks Inc. (note 4)	32,908	27,800
Future income taxes (note 8(c))	3,197	2,776
Property, plant and equipment (note 5)	1,809	1,453
Notes receivable (note 6)	425	373
	$ 52,625	$ 50,750
LIABILITIES		
Current liabilities		
Accounts payable	$ 5,125	$ 4,197
Accrued liabilities	4,849	3,973
Accrued royalties payable (note 11)	2,227	2,080
Income taxes payable	–	5,138
Deposits on franchise and equipment sales	806	843
	13,007	16,231
Deferred gain (note 3)	32,243	29,644
Long-term liabilities (note 7)	5,592	5,180
Non-controlling interest	94	80
	50,936	51,135
SHAREHOLDERS' EQUITY		
Capital stock (note 9)	10,500	10,500
Deficit	(8,811)	(10,885)
	1,689	(385)
	$ 52,625	$ 50,750

Commitments and contingencies (note 10)

Subsequent events (note 15)

Approved by the Board of Directors:

Director   Director

Consolidated Statements of Earnings and Deficit

(in thousands of dollars)

For the year ended	December 28, 2003	December 29, 2002
Revenue		
Franchising	$ 41,810	$ 39,153
Corporate restaurants	6,831	6,328
Dividend income (note 11)	3,016	2,282
	51,657	47,763
Direct costs and administrative expenses	35,012	32,282
Royalty expense (note 11)	13,633	11,452
	48,645	43,734
Earnings before the following	3,012	4,029
Interest (note 14)	38	1,239
Amortization (note 14)	459	1,883
Non-recurring items (note 14)	–	1,958
Amortization of deferred gain (note 3)	(2,509)	(2,647)
Earnings before income taxes and non-controlling interest	5,024	1,596
Provision for (recovery of) income taxes (note 8(a))	228	(16,733)
Earnings before non-controlling interest	4,796	18,329
Non-controlling interest	354	290
Net earnings for the year	4,442	18,039
(Deficit) retained earnings – Beginning of year	(10,885)	10,076
Dividends paid	(2,000)	(39,000)
Refundable dividend tax	(368)	–
Deficit – End of year	$ (8,811)	$ (10,885)

Consolidated Statements of Cash Flows

(in thousands of dollars)

For the year ended		December 28, 2003		December 29, 2002
Cash flows from operating activities				
Net earnings for the year	$	4,442	$	18,039
Items not affecting cash				
Amortization		459		1,883
Decrease in future income taxes - non-current		(421)		(24,484)
Loss (gain) on disposal of property, plant and equipment		2		(4)
Amortization of deferred gain		(2,509)		(2,647)
Increase in long-term liabilities		412		296
Increase in notes receivable		(52)		(373)
Non-controlling interest's share of earnings		354		290
		2,687		(7,000)
Net change in non-cash working capital		(5,676)		5,343
		(2,989)		(1,657)
Cash flows from investing activities				
Purchase of property, plant and equipment		(819)		(383)
Proceeds from disposal of property, plant and equipment		2		8
Proceeds from sale of intangible assets		–		84,876
		(817)		84,501
Cash flows from financing activities				
Repayment of long-term debt		–		(36,500)
Payment of dividends		(2,000)		(39,000)
Refundable dividend tax		(368)		–
Dividend to non-controlling interest		(340)		(420)
		(2,708)		(75,920)
(Decrease) increase in cash and cash equivalents		(6,514)		6,924
Cash and cash equivalents - Beginning of year		11,054		4,130
Cash and cash equivalents - End of year	$	4,540	$	11,054
Cash and cash equivalents consist of:				
Cash (bank indebtedness)	$	139	$	(600)
Short-term investments		4,401		11,654
	$	4,540	$	11,054
Supplementary cash flow information (note 14)				
Net interest received (paid)	$	265	$	(1,039)
Net income taxes paid	$	(6,251)	$	(4,413)

Notes to the Consolidated Financial Statements

December 28, 2003 and December 29, 2002

(figures in tables are expressed in thousands of dollars)

1 NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Nature of operations

The company is in the business of developing and franchising quick-service restaurants in Canada. During the year, the company franchised 34 locations, bringing the total number of franchised restaurants to 625.

The company also owns and operates 9 restaurants in the Ottawa region, which it intends to retain as a demonstration market.

Basis of presentation

These consolidated financial statements include the accounts of the company and its 60%-owned subsidiary, A&W Root Beer Beverages of Canada Inc. (Beverages). The non-controlling interest comprises the common equity of Beverages held by Unilever Canada Limited.

Fiscal year

To align its financial reporting with the business cycle of its operations, the company uses a fiscal year-end comprising a 52 to 53 week period ending the Sunday nearest December 31. The fiscal 2003 year-end date was December 28 (2002 - December 29).

Revenue recognition

The company grants franchises to independent operators who, in turn, pay an initial fee and service fees for each restaurant. The company also receives fees from franchisees for arranging the lease and development of the premises. The initial fee and equipment fee are recorded as income when the restaurant commences operation. Service fees in the amount of 2.5% to 3.5% of net sales of franchise operations are charged on a four-week period basis and recognized in income as received. All other revenue is recorded on an accrual basis.

Dividend income is recorded as dividends are declared.

Inventories

Inventories are valued at the lower of cost and net realizable value. Cost is determined using the first-in, first-out method.

Investment in A&W Trade Marks Inc.

The company's 28% (2002 - 25%) investment in the common shares of A&W Trade Marks Inc. (Trade Marks) is recorded on the equity basis.

The company's investment in the Trade Marks Class A and Class B shares is recorded at cost. If management determines there is a permanent decline in value, this investment will be written down to net realizable value.

Property, plant and equipment

Property, plant and equipment are recorded at cost less accumulated amortization.

Amortization

Amortization of property, plant and equipment is provided using the straight-line method. Machinery and equipment are amortized at rates from 7% to 50%. Amortization of leasehold improvements and related costs is charged over the term of the lease plus the first renewal term.

Income taxes

Income taxes are calculated using the liability method of tax allocation accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. Temporary differences arising from the acquisitions of assets or business may result in future income tax liabilities or assets.

Deferral and amortization of gain on sale of intangible assets

The gain on the sale of intangible assets is deferred and amortized over the term of the licence on a straight-line basis. Prior to October 2003, the amortization was based upon the present value of the expected royalty payments made under the licence agreement (note 2).

Royalty expense

Royalty expense is accrued at 3% of system sales and charged to earnings as the related revenue accrues.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks, and short-term investments with a maturity of three months or less.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates.

To facilitate the sale of certain corporate restaurants, the company has made provision for rent subsidies. It is possible that changes in future conditions could require a material change in the amounts accrued.

2 CHANGE IN ACCOUNTING POLICIES

Effective October 2003, the company prospectively adopted the new recommendations of the Canadian Institute of Chartered Accountants on what constitutes Canadian generally accepted principles and its sources. As a result of this change, the deferred gain on the sale of the trade-marks (note 3) is being amortized on a straight-line basis over the term of the licence agreement. The effect of the change on the current year's and next year's financial statements is to reduce the amortization of the deferred gain for the year by approximately $965,000 and $2,823,000 respectively and reduce net earnings for the year by approximately $861,000 and $2,517,000 respectively.

3 SALE OF INTANGIBLE ASSETS AND DEFERRED GAIN

On February 15, 2002, the company sold its A&W trade-marks to Trade Marks for $152,676,000, of which $112,676,000 was received on the date of sale. The balance of the purchase price (the Balance) of $40,000,000 is due, without interest, on December 31, 2006. The Balance may be settled in part or in total before December 31, 2006 as annual adjustments are made to the pool of restaurants contributing to the royalty to be paid to Trade Marks, as discussed below. For accounting purposes, the Balance of the purchase price and related gain will not be recorded until the amounts of annual adjustments to the royalty are determined.

Concurrent with the sale of the A&W trade-marks, Trade Marks granted a licence to the company to use the A&W trade-marks for a term of 99 years. In return, the company will pay Trade Marks a royalty of 3% of the gross sales reported to the company by the A&W restaurants in the royalty pool (the Licence and Royalty Agreement). Accordingly, for accounting purposes, the gain on the sale was deferred and is being amortized over the term of the licence.

On January 5, 2003, the number of A&W restaurants for which royalties are paid was increased by 27 new restaurants less eight restaurants which permanently closed during 2002. The company received $5,505,000 by issuance of 487,624 Class B and common shares of Trade Marks, as initial consideration for the estimated royalty stream from the 19 net restaurants added to the royalty pool. 20% of the shares were held in escrow until the 2003 gross sales of the new restaurants were known.

In December 2003, the actual gross sales of the new restaurants were determined and a reduction to the share consideration of $397,000 was made. This resulted in 62,370 of the 97,525 shares held in escrow being issued to the company and the remaining shares returned to Trade Marks.

The issuance of these shares comprises the first payment of the Balance of the purchase price on the sale of the A&W trade-marks and is recorded as an additional investment in Trade Marks with a corresponding increase in the deferred gain ($5,108,000).

During the year, $2,509,000 of the deferred gain was amortized (2002 - $2,647,000) (note 2).

The deferred gain on sale is determined as follows:

Proceeds on sale of A&W trade-marks	
Cash	$ 84,876
2,779,975 Class A shares of A&W Trade Marks Inc. (note 4)	27,800
2,780,000 common shares of A&W Trade Marks Inc. (note 4)	—
	112,676
Less: Net book value of intangible assets	80,385
Deferred gain on sale	32,291
Less: Amortization - 2002	(2,647)
Net deferred gain - December 29, 2002	29,644
Add: Additional share consideration - 2003 (note 4)	5,108
Less: Amortization - 2003 (note 2)	(2,509)
Net deferred gain - December 28, 2003	$ 32,243

4 INVESTMENT IN A&W TRADE MARKS INC.

The company's investment in A&W Trade Marks Inc. comprises:

	2003		2002	
	Number of shares	Amount	Number of shares	Amount
Class A shares	2,779,975	$ 27,800	2,779,975	$ 27,800
Class B shares	452,469	5,108	—	—
Common shares	3,232,469	—	2,780,000	—
		$ 32,908		$ 27,800

During the year, 452,469 Class B and common shares were received as consideration for the royalty stream from the 19 net restaurants added to the royalty pool (note 3).

The Class A and Class B shares are exchangeable at the option of the company into A&W Notes of Trade Marks on the basis of $10 principal amount of A&W Notes for one Class A or Class B share, and in turn, one common share of Trade Marks and a $10 A&W Note are exchangeable for a unit of the A&W Revenue Royalties Income Fund.

The Class A and Class B shares entitle the company to a fixed cumulative preferential cash dividend at a rate of $1.075 per share per annum. As at December 31, 2003, the cumulative dividends in arrears amounted to $808,000 (2002 - $338,000) (note 15(b)).

5 PROPERTY, PLANT AND EQUIPMENT

2003	Cost	Accumulated amortization	Net
Leasehold improvements and related costs	$ 1,790	$ 816	$ 974
Machinery and equipment	3,867	3,032	835
	$ 5,657	$ 3,848	$ 1,809

2002	Cost	Accumulated amortization	Net
Leasehold improvements and related costs	$ 1,313	$ 718	$ 595
Machinery and equipment	3,662	2,804	858
	$ 4,975	$ 3,522	$ 1,453

6 NOTES RECEIVABLE

The notes are receivable from certain franchisees with varying rates of interest up to 14.78%. The notes are repayable in monthly installments over periods not exceeding 10 years. At December 28, 2003, the notes outstanding amounted to $469,000 (2002 - $453,000), of which $44,000 (2002 - $80,000) is included in accounts receivable.

7 LONG-TERM LIABILITIES

	2003	2002
Long-term pension liability (note 12)	$ 5,173	$ 4,698
Long-term rent subsidies	468	534
Long-term employee benefits (note 12)	208	192
	5,849	5,424
Less: Current portion included in accrued liabilities	257	244
	$ 5,592	$ 5,180

8 INCOME TAXES

a) Provision for (recovery of) income taxes included in the consolidated statements of earnings is as follows:

Year ended	December 28, 2003	December 29, 2002
Current income taxes	$ 714	$ 7,682
Future income taxes		
Current	(65)	69
Non-current	(421)	(24,484)
	$ 228	$ (16,733)

b) The provision for (recovery of) income taxes shown in the consolidated statements of earnings differs from the amounts obtained by applying statutory tax rates to the earnings before income taxes for the following reasons:

Year ended	December 28, 2003	December 29, 2002
Statutory combined federal and provincial income tax	25.9%	35.5%
Provision for income taxes based on statutory income tax rates	$ 1,303	$ 567
Non-deductible items	52	83
Non-taxable portion of capital gains	(267)	(298)
Non-taxable dividends	(643)	(514)
Manufacturing and processing deduction	—	(71)
Rate change on future income taxes	(143)	(356)
Tax recovery on sale of trade-marks	(74)	(16,144)
Provision for (recovery of) income taxes	$ 228	$ (16,733)

c) Future income taxes comprise the following:

	2003	2002
Current		
Current tax reserves	$ 272	$ 207
Long-term assets		
Intangible assets	$ 779	$ 909
Long-term liabilities	1,993	1,747
Deferred gain	3,498	3,338
	6,270	5,994
Long-term liabilities		
Property, plant and equipment	(58)	(87)
Class A shares	(3,015)	(3,131)
	(3,073)	(3,218)
Net long-term future income tax asset	$ 3,197	$ 2,776

9 CAPITAL STOCK

Authorized

Unlimited number of common shares

Unlimited number of preferred shares

Issued

	2003	2002
4,781,250 common shares	$ 10,500	$ 10,500

10 COMMITMENTS AND CONTINGENCIES

Operating leases

The company has base rental obligations under operating leases for premises, equipment and automobiles. Certain of the premises leases require additional payments contingent on sales volume. The company generally arranges premises leases and enters into agreements whereby the company licences the premises to the franchisee, for which the company receives a premises licence fee. Under the terms of the agreements, the franchisee assumes all rights and obligations under the lease. Accordingly, the company records net lease expense in its consolidated statements of earnings.

The annual rental payments, excluding contingent rentals, are as follows:

For the year ending December 31

	Lease obligations	Subleases	Net Lease liability
2004	$ 15,525	$ 14,431	$ 1,094
2005	14,807	13,767	1,040
2006	14,446	13,525	921
2007	13,720	12,960	760
2008	12,778	12,163	615
Balance of commitments	73,635	72,136	1,499
	$144,911	$138,982	$ 5,929

Purchase obligations and lease and mortgage guarantees

The company has lease and mortgage guarantees of $327,000 (2002 - $338,000) and purchase obligations for supply to franchisees for food supplies, packaging and equipment of $17,028,000 (2002 - $16,828,000).

National Advertising Fund

The company maintains an advertising fund that is supported by prescribed contributions from corporate and franchise restaurants. At December 28, 2003, the fund had a surplus balance of $242,000 (2002 - $93,000).

Contingencies

In the normal course of operations, there are claims against the company. Specifically, there is one claim against the company for $580,000 for a dispute with a former franchisee. The company has counter-claimed for $200,000 alleging breach of contract. Management has assessed the company's likely liability for all claims outstanding and has made provision for these claims in the financial statements. The actual liability could differ from these estimates.

11 RELATED PARTY TRANSACTIONS AND BALANCES

Royalty expense

Pursuant to the Licence and Royalty Agreement (note 3), system sales from the royalty pool for the year amounted to $454,433,000 (2002 - $381,233,000) resulting in a royalty expense for the year of $13,633,000 (2002 - $11,452,000). At December 28, 2003, an accrued royalty expense of $2,227,000 (2002 - $2,080,000) is due to Trade Marks.

Dividend income

During 2003, dividend income of $3,016,000 (2002 - $2,282,000) was earned from Trade Marks, of which $334,000 (2002 - $258,000) is receivable at December 28, 2003.

12 EMPLOYEE BENEFITS

The company has a defined contribution pension plan. In addition, the company has entered into agreements with certain senior officers pursuant to which the company has an unfunded liability to pay each of them a supplementary retirement benefit. The accrued benefit obligation and related expense are actuarially determined using a current settlement discount rate. The unfunded liability of the company under these agreements as at December 28, 2003, assuming retirement of each officer at normal retirement age, was $5,173,000 (2002 - $4,698,000) and is included in long-term liabilities (note 7).

Pension expense for the year was $568,000 (2002 - $519,000).

The long-term employee benefits comprise medical, dental and pension benefits payable to former employees who are on long-term disability.

13 FINANCIAL INSTRUMENTS

The carrying values of cash and cash equivalents, accounts receivable and payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity of these instruments.

The long-term notes receivable bear interest at market rates and therefore it is management's opinion that the carrying value approximates the fair value. The Class A and Class B shares of Trade Marks are recorded at cost and the common shares of Trade Marks are recorded on the equity basis. Their fair values will fluctuate in proportion to the quoted value of units of A&W Revenue Royalties Income Fund, which at December 28, 2003 exceed their carrying values.

14 SUPPLEMENTARY EARNINGS AND CASH FLOW INFORMATION

Year ended	**December 28, 2003**	December 29, 2002
Interest expense		
Interest on long-term debt	$ —	$ 206
Interest income	(262)	(385)
Other	300	274
Settlement of debt hedging transactions	—	1,144
	$ 38	$ 1,239
Amortization		
Amortization of intangible assets	$ —	$ 363
Amortization of property, plant and equipment	459	476
Write-off of deferred financing fees	—	1,044
	$ 459	$ 1,883
Non-recurring items		
Bonus paid under phantom share plan	$ —	$ 1,517
Other	—	441
	$ —	$ 1,958
Non-cash investing activities		
Investment in A&W Trade Marks Inc.	$ 5,108	$ 27,800

15 SUBSEQUENT EVENTS

a) 2004 adjustment to the royalty pool

On January 5, 2004, the number of A&W restaurants for which royalties are paid to Trade Marks was increased by 28 new restaurants less 12 restaurants which permanently closed during 2003. The company received $5,134,000, by issuance of 488,476 Class B and common shares of Trade Marks, as initial consideration for the estimated royalty stream from the 16 net restaurants added to the royalty pool. A final adjustment to the share consideration will be made in December 2004 based upon the 2004 gross sales reported by the new restaurants. 20% of the shares are held in escrow until the 2004 gross sales of the new restaurants are known.

The shares comprise the second payment of the Balance of the purchase price on the sale of the A&W trade-marks (note 3) and will be recorded as an additional investment in Trade Marks with a corresponding increase in the deferred gain.

b) Declaration of dividends on Class A and Class B shares of Trade Marks

On January 20, 2004, Trade Marks declared a dividend on its Class A and Class B shares of $551,000, payable on January 30, 2004. This dividend is in respect of the cumulative undeclared dividends in arrears on Class A and Class B shares at December 31, 2003 (note 4).

Management of A&W Food Services

JEFFERSON MOONEY
CHAIRMAN AND
CHIEF EXECUTIVE OFFICER

Jeff Mooney joined A&W Food Services in 1973, became President and Chief Executive Officer in 1991 and Chairman in 1994. He holds a Bachelor of Arts degree from the University of Saskatchewan and is an alumnus of the Harvard University School of Business. In addition, Jeff is the Past-Chairman of the British Columbia Business Council, a director of The Cadillac Fairview Corporation Limited and a director of Finning International Inc.

PAUL F.B. HOLLANDS
PRESIDENT AND
CHIEF OPERATING OFFICER

Paul Hollands joined A&W Food Services in 1981, became Executive Vice President and Chief Operating Officer in 1995 and President in 2002. He holds a Bachelor of Commerce degree from the University of British Columbia, is past chairman of the Canadian Restaurant and Foodservices Association, a member of the Canadian Committee of the International Council of Shopping Centres, and a recipient of the first class of Canada's national Top 40 Under 40 leadership award. Paul also sits on the Advisory Board, Sauder School of Business - the University of B.C., and is a Board member of the St. Paul's Hospital Foundation.

AXEL F. REHKATSCH
SENIOR VICE PRESIDENT AND
CHIEF FINANCIAL OFFICER

Axel Rehkatsch joined A&W Food Services in 1975 and became Senior Vice President and Chief Financial Officer in 1995. He holds a Bachelor of Commerce degree from the University of British Columbia and a Chartered Accountant designation. Axel is also a graduate of the Advanced Program of Hospitality Management of the University of Guelph and of the Extended Education Program of the Harvard University School of Business. He is a Board member of the Canadian Association of Income Trusts.

J. GRAHAM COOKE
VICE PRESIDENT,
DEVELOPMENT

Graham Cooke joined A&W Food Services in 1981, became Director of Purchasing and Distribution in 1986, Vice President of Franchising in 1991, Vice President, Operations in 1997 and Vice President, Development in 2002. He holds a Masters of Business Administration degree from Queen's University. Graham is also past director of the Canadian Franchise Association and currently serves on its Pacific Region Advisory council.

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of Canada Inc.**

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